Supreme Court, U.S.
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IN THE

Supreme Court of the United States

ALAN NISSELSON, Trustee of the Dictaphone Litigation Trust, successor-in-interest to claims of Dictaphone Corporation,

Petitioner,

—v.—

JO LERNOUT, *et al.*,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Where an acquiring company succeeds in fraudulently merging with its target, and the target's securities fraud claims pass first to the defrauding acquirer's subsidiary as a matter of law, and thereafter to a bankruptcy estate and a litigation trustee, may the trustee be denied recovery on the ground of *in pari delicto only* if the two-part test adopted by this Court in *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299 (1985) is met?

2. Does a trustee or receiver "bear at least substantially equal responsibility for the violations he seeks to redress" as "a direct result of his own actions" thereby satisfying the first prong of the *Bateman Eichler* test whenever principles of imputation make him responsible for the wrongs of a "guilty" predecessor?

3. Does Section 541 of the Bankruptcy Code require a finding that a trustee acquiring the claims of a debtor bears "equal responsibility" as "a direct result of his own actions" for the wrongs underlying those claims whenever the debtor would have been found to have "equal responsibility"?

4. Does a rule of law denying recovery to all trustee successors for all defrauded merger targets "significantly interfere with the effective enforcement of the securities laws and protection of the investing public" under the second prong of the *Bateman Eichler* test, thereby requiring the defense to be denied?

5. Does Section 541 of the Bankruptcy Code create a federal rule of imputation consistant with this Court's ruling in *O'Melveny & Myers v. FDIC*, 512 U.S. 79 (1994), thereby requiring all trustees obtaining rights to claims in bankruptcy to be found *in pari delicto* on all state law causes of action whenever the debtor would have been so found, irrespective of the provisions of state law otherwise governing the claim and defense?

LIST OF PARTIES – Rules 14.1(b) and 29.6

A. Parties Originally Named in the District Court.

Jo Lernout; Pol Hauspie; Nico Willaert; Gaston Bastiaens; Carl Dammekens; Ellen Spooren; Ju-Chul Seo; Erwin Vandendriessche; RVD Securities N.V.; Dick Cauwelier; Marc G.H. DePauw; Francis Vanderhoydonck; Gerard van Acker; S.A.I.L. Trust V.Z.W., Flanders Language Valley Fund; Flanders Language Valley Fund Management; Lessius Management Consulting, N.V.; Gewestelijke Investeringsmaatschappij Vlaanderen N.V.; L&H Investment Company, N.V.; Language Investment Company; Language Development Services: Mercator and Noordstar N.V.; Language Development Fund; Velstra Pte Ltd., Louis H. Verbeke; Willem Hardeman; Tony Snauwaert; Klynveld Peat Marwick Goerdeler Bedrijfsrevisoven; KPMG LLP; Paul Behets; SG Cowen Securities Corporation; Chase Securities, Inc., as successor to Hambrecht & Quist; Deloitte & Touche; Stonington Partners, Inc.; Stonington Capital Appreciation 1994 Fund L.P.; Stonington Holdings, LLC; John H. Duerden; Albert J. Fitzgibbons, III; Emil F. Jachmann; Alexis P. Michas; Scott M. Shaw; Joseph D. Skrzypczak; and Peter P. Tong.

B. Changes of Parties in the District Court.

The District Court entered judgment solely as to Jo Lernout; Pol Hauspie; Nico Willaert; Gaston Bastiaens; Carl Dammekens; Ellen Spooren; Ju-Chul Seo; Erwin Vandendriessche; RVD Securities N.V.; Dick Cauwelier; Marc G.H. DePauw; Francis Vanderhoydonck; Gerard van Acker; S.A.I.L. Trust V.Z.W., Flanders Language Valley Fund; Flanders Language Valley Fund Management; Lessius Management Consulting, N.V.; Gewestelijke Investeringsmaatschappij Vlaanderen N.V.; L&H

Investment Company, N.V.; Language Investment Company; Language Development Services: Mercator and Noordstar N.V.; Language Development Fund; Velstra Pte Ltd., Louis H. Verbeke; Willem Hardeman; Tony Snauwaert; Klynveld Peat Marwick Goerdeler Bedrijfsrevisoven; KPMG LLP; Paul Behets; SG Cowen Securities Corporation. Chase Securities, Inc. and Deloitte & Touche are no longer parties to the action. The case to the remaining parties is pending.

C. Changes of Parties in the Court of Appeals.

None

CORPORATE DISCLOSURE STATEMENT

The Dictaphone Litigation Trust is a trust, without shareholders, parents or subsidiaries. KBC Bank, N.V. and Fortis Bank, N.V. each have a beneficial interest in the Trust exceeding 10%.

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OPINIONS BELOW

The opinion of the Court of Appeals is reported at 469 F.3d 143 (1st Cir. 2006) and is reprinted in the Appendix hereto at 1a to 25a.

The opinion of the District Court granting the Motion to Dismiss the Amended Complaint filed by SG Cowen Securities Corporation ("Cowen") is reported at 2004 U.S. Dist. LEXIS 13648 (D. Mass., July 21, 2004) and is reprinted at 26a to 40a. A further Memorandum and Order allowing the motions to dismiss of various other defendants is not reported and is reprinted at 41a to 42a. Two unreported orders of the District Court granting the motions by certain defendants for an order pursuant to Rule 54(b) to enter a separate judgment of dismissal are reprinted at 43a to 45a, and 46a to 48a. A further unreported order of the District Court amending the prior judgment to correctly specify the parties against whom all claims were dismissed is reprinted at 49a to 50a. An unreported order of the Court of Appeals pursuant to Rule 60(a), allowing the District Court to enter the corrected judgment is reprinted at 51a to 53a.

JURISDICTION

The District Court had subject matter jurisdiction of this action pursuant to Section 27 of the Exchange Act, 15 U.S.C. § 78aa, 28 U.S.C. §§ 1331 and 1337, and the principles of supplemental jurisdiction under 28 U.S.C. § 1367. The Court of Appeals affirmed the District Court's dismissal of the claims against certain named defendants on November 8, 2006. Pursuant to the Order of Justice Souter dated February 2, 2007, this petition is due to be filed on February 23, 2007. This Court has jurisdiction pursuant to 28 U.S.C. § 1254.

PERTINENT CONSTITUTIONAL AND STATUTORY PROVISIONS

Section 541 of the Bankruptcy Code, 11 U.S.C. § 541, Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), Rule 10(b)(5), 17 C.F.R. § 240.10b-5(2000), and the pertinent provisions of the Racketeer Influence and Corrupt Organization Act, 18 U.S.C. §§ 1962 and 1964 are reprinted in the appendix hereto at App. 54a to 63a.

STATEMENT OF THE CASE

A. INTRODUCTION

This case involves the proper scope of the *in pari delicto* defense when it is asserted against a claim by a Trustee or receiver who has inherited the claim from a wrongdoer. Both logic and experience indicates that this is the context in which the defense is most likely to be raised since a corporate wrongdoer is most likely to sue its confederates after those in charge of the wrongful acts have lost corporate control.

Absent clear guidance from this Court on the issue, and there has been none, it is perhaps not surprising that the issue of whether a Trustee is continued to be burdened with the *in pari delicto* defense to the same extent as his predecessor-in-interest is one which has deeply split the circuits. What is surprising, however, is how frequently the circuits have decided the issue without reference to the governing precedents from this Court, and that even those who did address this Court's requirements applied them inconsistently.

The application of the *in pari delicto* defense in federal courts is governed by two decisions of this Court, both of which were misapplied by the First Circuit below. In the first, *Bateman Eichler, Hill Richards, Inc.*

v. Berner, 472 U.S. 299 (1985) this Court held that a private securities fraud suit for damages, or other like cases involving federal law claims implicating the public interest, "may be barred on the grounds of the plaintiff's own culpability *only* where"

> (1) as a direct result of his own actions, the plaintiff bears at least substantially equal responsibility for the violations he seeks to redress, and (2) preclusion of suit would not significantly interfere with the effective enforcement of the securities laws and protection of the investing public.

Id. at 310-11, emphasis supplied.

In the second, *O'Melveny & Myers v. FDIC*, 512 U.S. 79 (1994), this Court held that in contrast to those strict requirements for allowing the defense in cases arising under federal law, where the claims asserted arise under state law, then, state law principals alone govern the application of the defense to those state law claims.

In determining the critical issue under the first prong of the *Bateman Eichler* test, whether the Trustee's liability in this case is "substantially equal" to that of the defendants, the First Circuit ignored *Bateman Eichler* and the policies behind it. Instead, the court of appeals focused exclusively on the "genealogy" of the Trustee's claim, as having passed through the hands of a wrongdoer. Although the claim rose in innocence as a claim of a defrauded merger target, and was asserted by an innocent trustee, acting for the benefit of the innocent creditors, the First Circuit applied a mechanical test. It held that a bankruptcy trustee, and therefore the Trustee in this case, "stands in the shoes" of his predecessor, and is barred by *in pari delicto* if his predecessor would have been. As we show below in Point 1.A, this approach is

contrary to the *Bateman Eichler* rule and long standing concepts of equity jurisprudence.

The second prong of the *Bateman Eichler* test was misapplied following the same mechanical approach. Since the Trustee was found by the court of appeals to be a "guilty" participant (by imputation), the policies of the securities laws were not interfered with since those laws do not exist to give wrongdoers a "second bite at the cherry." App. at 23a. Allowing the resolution of the *Bateman Eichler* "equal guilt" prong (particularly when guilt is solely through imputation) to determine the result of the "significant interference" prong, effectively nullifies the second prong of the *Bateman Eichler* test. Further, as we show in Point 2 below, a rule of law that insulates from suit those who participate in fraudulent corporate acquisitions clearly does interfere with the "effective enforcement of the securities laws and protection of the investing public," and for that reason alone the decision below merits reversal.

The court of appeals also dismissed the state law claims using its court devised federal law of imputation which, as we show below in Point 3, is contrary to this Court's holding in *O'Melveny* and contrary to governing Massachusetts law.

This case calls for review by this Court, however, not merely because of the errors of the First Circuit below, however serious, but because those similar failures to apply this Court's rulings in *Bateman Eichler* and *O'Melveny* have occurred in case after case, and in growing numbers, and will continue to occur until this Court clarifies the issues. The First Circuit decision in this case below followed the Eleventh Circuit in *Official Committee of Unsecured Creditors of PSA, Inc. v. Edwards*, 437 F.3d 1145 (2006) which contained the same errors.

The Third Circuit in *Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co.*, 267 F.3d 340, 357 (3d Cir. 2001) applied *in pari delicto* to bar federal and state law claims of a creditors' committee without even citing *Bateman Eichler*, and by applying a federal standard of imputation, contrary to the command of *O'Melveny* and of Pennsylvania law which governed the state law claims. *See* Point 3, *infra*. In *In re The Personal and Business Insurance Agency v. McNamara*, 334 F.3d 239 (3d Cir. 2003), the same circuit, again without citation to *Bateman Eichler*, held a bankruptcy trustee *was not* prohibited from recovering fraudulent conveyance based on the debtor's participation in pre-petition fraudulent conveyances.

The Seventh Circuit reached the conclusion in *Scholes v. Lehmann*, 56 F.3d 750, 754 (7th Cir. 1995) that "the defense of *in pari delicto* loses its sting when the person who is *in pari delicto* is eliminated." Citing Illinois cases and Supreme Court precedent, but notably not the *Bateman Eichler* decision, the defense was rejected for both federal securities and state law claims.[1]

Similarly, the Eighth, Sixth and Tenth Circuits have held a bankruptcy trustee's state law claims is barred by *in pari delicto* if his predecessor would have been using federal court made imputation law in violation of the rule in *O'Melveny*.[2] The Second Circuit has followed its

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[1] *Accord FDIC v. O'Melveny & Myers*, 61 F.3d 17, 19 (9th Cir. 1995) ("While a party may itself be denied a right or defense on account of its misdeeds, there is little reason to impose the same punishment on . . . [an] innocent entity that steps into the party's shoes pursuant to court order or operation of law.")

[2] *E.g., Grassmueck v. Am. Shorthorn Ass'n*, 402 F.3d 833, 836 (8th Cir. 2005) (applying *in pari delicto* to bar state law claims of bankruptcy trustee based on federal court made imputation rule); *Terlecky v. Hurd (In re Dublin Sec)*, 133 F.3d 377 (6th Cir. 1997), cert. denied, 1998 U.S. LEXIS 4792 (October 5, 1998) (same); *In re:*

own drummer and held that a bankruptcy trustee loses standing to assert claims where the debtor has participated in the wrongdoing.[3]

This large and growing list of circuit court cases disregarding or conflicting with this Court's governing opinions and the still larger number of district court and Bankruptcy Court cases containing the same defects, have undermined the continuing vitality of both *Bateman Eichler* and *O'Melveny*. There can be little doubt that this case, presenting errors in application of both of those precedents, merits review by this Court to clarify the proper application of *Bateman Eichler* and *O'Melveny* to suit by trustees and receivers.

B. STATEMENT OF THE FACTS

On May 5, 2000, in a merger pursuant to Section 259 of the Delaware General Corporate Law, Dictaphone Corporation ("Dictaphone" or sometimes "Old Dictaphone") transferred all its assets and its business, then valued at approximately $900,000,000, to Dark Acquisition Corp. ("Dark" and subsequent to the merger, "New Dictaphone"), a newly-created wholly-owned subsidiary of L&H.

The Merger Agreement, which was executed on March 7, 2000, contains representations and warranties from L&H to Dictaphone in Article IV, including representations concerning the accuracy of filed financial statements. Those representations were the subject of extensive "due diligence" by Dictaphone and in the course of

Hedged-Investments Assocs., Inc., 84 F.3d 1281 (10th Cir. 1996) (same).

[3] *See, e.g., Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114 (2d Cir. 1991); *Mediators, Inc. v. Manney (In re Mediators, Inc.)*, 105 F.3d 822, 825-26 (2d Cir. 1997); *and Hirsch v. Arthur Andersen & Co.*, 72 F.3d 1085, 1094 (2d Cir. 1995).

which defendants made face-to-face representations to Dictaphone, upon which Dictaphone relied. Dictaphone itself hired professional advisors, who were also subjected to misrepresentations from defendants in performing their work for Dictaphone.

Unknown to Dictaphone, the consideration it received for its transfer of $900,000,000 in business and assets, including (but not limited to) stock of L&H and the assumption of Dictaphone's liabilities, was essentially worthless due to the existence of a massive fraudulent scheme to artificially inflate L&H's reported revenues and profits which L&H had been engaged in since at least 1996. As a result, within months of the merger, both L&H and Dictaphone were forced into bankruptcy and Dictaphone lost nearly its entire net worth.

The L&H scheme involved the use of related or controlled companies through which L&H would funnel loans or venture capital, or sometimes its own money, which would then be given to L&H and fraudulently recorded by L&H as revenue. Initially, the scheme involved two corporations called Dictation Consortium and the Brussels Translation Group ("BTG"). The scheme was later expanded to a series of twenty so-called Language Development Companies ("LDCs") and Cross-Language Development Companies ("CLDCs") (the "LDC/CLDC Fraud"). Like the Dictation Consortium and BTG, the LDCs and CLDCs were effectively controlled by L&H, but that relationship was concealed.

Following the acquisition by L&H of a Korean telecommunications company, Bumil, in September 1999, L&H also embarked on a related fraud to enter into sales contracts at wildly inflated prices with a series of essentially shell companies, and to fraudulently book the revenues from these contracts, even though the pur-

chasers had not—and could not—pay the contract price (the "Korean Revenue Fraud").

L&H ultimately admitted that various fraudulent schemes inflated L&H revenues in the period 1998 through June 2000 by $373 million, nearly two-thirds of the total, and the profits of L&H, reported to Dictaphone at the time of the merger as $70 million, in actuality was a $70 million loss. L&H, which had boasted a market capitalization of $8 billion, was essentially worthless. Defendants were all alleged to have directly participated in the L&H scheme. Absent the fraud, Dictaphone never would have agreed to the merger.

Upon discovery of the fraud, L&H and its fraudulently-acquired subsidiary Dictaphone were compelled to file for protection under the United States Bankruptcy Code. Pursuant to Dictaphone's plan of reorganization, Dictaphone's claims were assigned to the "Dictaphone Litigation Trust," of which Plaintiff-Appellant, Alan Nisselson, is the Trustee. Plaintiff-Appellant, by this action, seeks to recover the "damages suffered by Dictaphone as a result of the fraudulent course of conduct."

The damages alleged in the Amended Complaint are identified generally as "including, *but not limited to*, loss or diminution of its value as a going concern and consequential damages in an amount to be proven at trial, but no less than $900,000,000." The $900,000,000 number corresponds to the value of Dictaphone business and assets which it surrendered in the merger. The Amended Complaint does not assert any claim or cause of action premised on any injury, other than injuries to Dictaphone.

C. THE DISTRICT COURT DECISION

The District Court addressed the issues presented by the dismissal motions as sub-categories of the issue of

standing. The Court found that the case was "much complicated by the fact that the bankrupt corporation was wholly-owned by the alleged perpetrator of the fraud." App. at 34a. The Court first addressed the issue of *in pari delicto*. Significantly, although federal securities fraud and RICO claims were asserted, the District Court did not even mention, let alone address, the standards governing the application of the *in pari delicto* defense to Federal claims as set forth by this Court in *Bateman Eichler, Hill Richards, Inc. v. Berner et al.*, 477 U.S. 299 (1985); and *Pinter v. Dahl*, 486 U.S. 622 (1988). Nor did the District Court evaluate the state law claims applying Massachusetts state law principals[4] as required by this Court's decision in *O'Melveny & Myers v. FDIC*, 512 U.S. 79 (1994).

Instead, the District Court, relying primarily on the Second Circuit's decision in *Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114 (2d Cir. 1991) and its progeny,[5] the District Court held that "Courts have consistently held that claims for fraud or misrepresentation perpetrated on investors belong exclusively to those investors to the exclusion of the corporation or its successor in interest, where the corporation itself was

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[4] While the district court did not discuss choice of law issues Massachusetts, the state where the merger was consummated, L&H and Dark existed and many of the fraudulent misrepresentations occurred was the state whose law would apply to the dispute.

[5] *Mediators, Inc. v. Manney (In re Mediators, Inc.)*, 105 F.3d 822, 825-26 (2d Cir. 1997); *and Hirsch v. Arthur Andersen & Co.*, 72 F.3d 1085, 1094 (2d Cir. 1995). The district court also relied on *E.F. Hutton & Co. v. Hadley*, 901 F.2d 979, 987 (11th Cir. 1990), where a trustee for the perpetrator of a Ponzi scheme, GIC, had no standing to on claims belonging only to GIC customer creditors, and *Williams v. California 1st Bank*, 859 F.2d 664, 666-67 (9th Cir. 1988), where a bankruptcy trustee was held not to have standing to pursue creditors claims which the trustee had received by way of assignment.

involved in the wrongdoing." App. at 35a. The court dismissed the Trustee's argument that "Old Dictaphone" was the victim of the fraud holding: "Old Dictaphone cannot arise Phoenix-like to assert pre-merger claims against third parties that New Dictaphone could not assert." App. at 36a.

As an alternative ground for its holding that the Trustee had no standing, the District Court held that the loss of value resulting from a stock for stock merger was injury either directly to the shareholders, or directly to the creditors. App. at 39a-40a. The court found any separate harm to the "value of the corporation as a going concern" to be "speculative." App. 40a. Applying the test established by the Delaware Supreme Court in the then-recently decided case of *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004), the District Court found no standing on that ground as well. *Id.*

D. THE COURT OF APPEALS

While the Court of Appeals affirmed the District Court, it did so under very different reasoning. The Court rejected entirely the standing conclusions of the district court. It held that the *in pari delicto* defense is an "affirmative defense," not a matter of "standing." App. at 9a. It also held that the issue of *who* has the right to assert a claim (in this case the shareholders, as held by the District Court, or the Trustee) turns on a question of prudential standing not Article III standing, and therefore need not be resolved as a threshhold matter. App. at 10a. The court declined to address what it considered an unsettled matter of Delaware law. App. at 11a.

In addressing the *in pari delicto defense*, the court of appeals found that Massachusetts law paralleled federal law as set forth in *Bateman Eichler*. App. at 12a-13a. It

also held that the application of the defense need not be separately analyzed claim by claim because "the analysis ordinarily will be the same across a spectrum of different causes of action," App. at 13a, citations omitted, and any argument that analysis differed claim by claim or between state and federal law had been "waived." App. at 13a.[6]

Having disposed of the preliminaries, the court of appeals proceeded to analyze the applicability of the defense to the Trustee here without regard to the *Bateman Eichler* rule or the parallel state law. Instead, the court emphasized that any claim for Old Dictaphone for fraud committed upon it passed through New Dictaphone before being acquired by the Trustee. The court concluded that

> Because the lineage of the trustee's claims passes directly through New Dictaphone, any right that the trustee may have to assert those claims derives directly from New Dictaphone. . . . The trustee may assert only those claims that New Dictaphone could have asserted prior to seeking the protection of the bankruptcy court.

App at 14a.

The court relied on Bankruptcy Code Section 541, *Mediators, Inc.*, *Edwards*, and *Lafferty* to support its conclusion.

Once having reached that conclusion, the court of appeals completely disregarded the equities and complexities of the case which *Bateman Eichler* and parallel state law required it to consider. Instead, the imputation of guilt to the Trustee effectively resolved

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[6] The Trustee had argued, with citations to authority, that barring the claim was inequitable under both federal and state law.

every other issue and overcame every other equity and policy.

That the Trustee was of equal fault was dictated by the fact that the Trustee was in effect New Dictaphone, and the equities arising from the genesis of the claim or the replacement of Old Dictaphone were disregarded. App. at 16a-22a. The allowance of the defense would not interfere with the purposes of the securities law because the Trustee was guilty (by imputation) and the law is not designed to protect the guilty. App. at 23a.

The court found it "preferable" that the creditors sue individually, rather than through a trustee, because it speculated that L&H "may well" be a beneficiary of the trust. App. at 23a.[7] It noted that the creditors could still sue former directors, controlling shareholders and outside accounting professionals, without noting the serious policy implications of allowing direct participants in fraud to escape liability while holding merely negligent parties to account. *See* App. at 24a.

THE REASONS FOR GRANTING THE WRIT

1. The Question of Whether a Trustee May Be Held "*In Pari Delicto*" on Federal Claims because of his Predecessor's Fault is an Important Issue Left Open by this Court in *Bateman Eichler*, which has Split the Circuits

The language of *Bateman Eichler* allows for no exception. The *in pari delicto* defense may be applied to a suit by a trustee or receiver "*only*" if the two prongs of the *Bateman Eichler* test are met. The courts of appeals have

[7] Any concern on that front should have been resolved by the fact that L&H had been through its own bankruptcy and its creditors, not its guilty principals, would benefit in that event. *See, Baena v. KPMG LLP*, 453 F. 3d 1 (1st Cir. 2005).

discussed whether a trustee or receiver should be considered to be of "substantially equal" guilt. But like the First Circuit below, they have not analyzed that issue addressing the language used or the policies behind the *Bateman Eichler* decision.

The first prong of the *Bateman Eichler* test was framed in a way that suggested only the fault of the litigant appearing before the Court is to be considered. As the this Court held, an *in pari delicto* defense could apply in federal securities fraud cases "where . . . as a *direct result* of his *own* actions" there is "at least substantially equal responsibility" for the violations he seeks to redress." *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. at 310-11 (emphasis supplied).

The emphasis by this Court on the "direct result" and the parties' "own actions" would seem to preclude the use of the defense when the parties' liability for wrongful conduct is a result of vicarious liability, principles of agency, or imputation, rather than direct participation in the wrongful conduct alleged. The need to show the plaintiff's direct personal involvement in the wrong was re-emphasized in *Pinter v. Dahl*, 486 U.S. 622 (1988), where this Court held:

> Under the first prong of the *Bateman Eichler* test, as we have noted above, a defendant cannot escape liability unless, as a *direct result of the plaintiff's own actions*, the plaintiff bears at least substantially equal responsibility for the underlying illegality. The *plaintiff must be an active, voluntary participant in the unlawful activity* that is the subject of the suit. *See Woolf v. S. D. Cohn & Co.*, 515 F.2d 591, 604 (CA5 1975), *vacated and remanded on other grounds*, 426 U.S. 944 (1976) . . ."

Id. at 635-636 (emphasis added).

A similar formulation also appears in Justice Harlen's concurrence and dissent in *Perma Life Mufflers v. International Parts Corp.*, 392 U.S. 134 (1968): "Plaintiffs who are truly *in pari delicto* are those *who have themselves violated* the law in cooperation with the defendant." *Id.* at 153. (emphasis supplied).

It is true that these cases did not address the question presented here, whether a trustee who succeeds to the rights of a corporate wrongdoer is considered guilty to the same extent as his predecessor. However, the least that can be said about that issue is that the language of the cases leaves it open to be resolved. That conclusion is buttressed by the fact that the *Bateman Eichler* Court declined to resolve the argument raised by an amicus Securities Industry Association ("SIA") as to whether a liability of a "controlling person" of the defrauding party has a better ground for asserting the defense when the controlling person's liability was only 'vicarious' and 'secondary'." *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. at 314.

The circuit court opinions have addressed the issue of the application of *in pari delicto* to trustees or receivers have deeply split. Those courts which have addressed the issues in terms of general equitable principles or specific state law have found that the Trustee is not barred by his predecessor's wrongs. *See, e.g., Scholes v. Lehmann*, 56 F.3d 750, 754 (7th Cir. 1995) ("the defense of *in pari delicto* loses its sting when the person who is *in pari delicto* is eliminated."); *FDIC v. O'Melveny & Myers*, 61 F.3d 17, 19 (9th Cir. 1995) (holding under California law "While a party may itself be denied a right or defense on account of its misdeeds, there is little reason to impose the same punishment on . . . [an] innocent entity that steps into the party's shows pursuant to court order or operation of law"); *In re The Personal*

and Business Insurance Agency v. McNamara, 334 F.3d 239 (3d Cir. 2003) (same).

Those courts to have allowed the defense against a Trustee have generally followed a more mechanical approach, concluding that a trustee "steps into the shoes" of his predecessor and has no defenses that the predecessor did not have. Those courts, including the First Circuit below, have relied upon Bankruptcy Code Section 541 as the basis for their assertion and have not tried to reconcile that provision with *Bateman Eichler*. *See*, App. at 14a-15a; *Official Committee of Unsecured Creditors of PSA, Inc. v. Edwards*, 437 F.3d 1145 (2006); *Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co.*, 267 F.3d 340, 357 (3d Cir. 2001).

Under the general principles which underlie *Bateman Eichler*, the defense should not be allowed unless the particular equities of the case demand otherwise. Section 541 does not require that the important public policy concern for enforcement of federally-protected rights should be disregarded when a bankruptcy trustee pursues those claims.

A. Under General Equitable Principles and with regard to the Limited Role of *In Pari Delicto* Defense in Federal Claims, a Trustee is Not "of Equal Fault" with the Wrongdoer

The place to begin the analysis is with *Bateman Eichler* itself. It is beyond question that allowing trustees to pursue suits will advance the purposes of enforcement of federal law. That result shall only be thwarted if there are strong reasons to require it. But review of the equitable underpinnings of the rule supports barring the defense, not enforcing it.

As this Court noted in *Bateman Eichler*, the *in pari delicto* defense st[illegible]ds on two grounds: "First, that the

Court should not lend their good offices to mediating disputes among wrongdoers, and second, that denying judicial relief to an admitted wrongdoer is an affective means of deterring illegality." 472 U.S. at 306. Neither of these grounds for the defense is truly implicated when a trustee is suing wrongdoers to obtain assets for creditors of a debtor.

As to the first ground, allowing an innocent Trustee to pursue claims against guilty parties for the benefit of innocent creditors can hardly be said to compromise the integrity of the courts. This Court has recognized the propriety of proceeding on behalf of a receiver even where the receiver's predecessor would have been barred by fraud. In *McCandless v. Furlaud*, 296 U.S. 140 (1935), a suit was initiated by a receiver of an insolvent corporation to compel the corporate promoters, their confederates, to restore property that would be diverted from the corporation as a result of a fraudulent scheme. The corporation shareholders, promoters and directors were all involved. The Court of Appeals had dismissed the receiver's case on the ground that the consent of the shareholders to the fraudulent transaction bound the corporation and the receiver stood in no better position. This Court reversed in an opinion by Justice Cardozo holding:[8]

> There is no occasion to consider whether the corporation itself at the instance of new shareholders would be permitted to disaffirm the fraud and main-

[8] *McCandless* was distinguished by this Court in *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416, 429 (1972). *Caplin* held that under the applicable bankruptcy statutes a bankruptcy trustee was not entitled to pursue causes of action which belong to creditors. In *McCandless*, the Court noted, the receiver was "suing on behalf of the corporation, not third parties." *Id.* The Trustee in this case is likewise suing on behalf of the corporation, Dictaphone, for its own losses.

> tain a suit in equity for appropriate relief. We put that question by. Enough that the receiver has the requisite capacity. *Id.*, at 160-161.

Relying on *McCandless* and general equitable principals, in *Scholes v. Lehmann*, 56 F.3d 750, 754 (7th Cir. 1995) Judge Posner explained the reason and the policy behind denying the *in pari delicto* defense when a suit is brought by a receiver or trustee.

> Now that the corporations created and initially controlled by Douglas are controlled by a receiver whose only object is to maximize the value of the corporations for the benefit of their investors and any creditors, we cannot see an objection to the receiver's bringing suit to recover corporate assets unlawfully dissipated by Douglas.

Scholes v. Lehmann, 56 F.3d at 754-755.

Similar conclusions about the equity of allowing trustees or receivers to pursue claims free of the *in pari delicto* defense have been reached by other circuit courts applying general equitable principals. *McNamara v. PFS (In re Personal & Bus. Ins. Agency)*, 334 F.3d at 246 ("as the bad actor, Kesselring, has been eliminated and the trustee comes to us with clean hand, representing the interests of innocent creditors. If the doctrine of imputation were applied to bar PBI's recovery, that application would lead to an inequitable result (loss to innocent creditors)."). *FDIC v. O'Melveny & Myers*, 61 F.3d 17, 19 (9th Cir. 1995) ("While a party may itself be denied a right or defense on account of its misdeeds, there is little reason to impose the same punishment on . . . [an] innocent entity that steps into the party's shoes pursuant to court order or operation of law.") (applying California law). Similar rulings have been made by state courts applying general equitable principals. *See, e.g. ISP.com,*

LLC v. Theising, 805 N.E.2d 767, 772-773 (Ind. 2004); *Universal Builders, Inc. v. Moon Motor Lodge, Inc.*, 430 Pa. 550 (Pa. 1968); *Albers v. Continental Illinois Bank & Trust Co.*, 296 Ill. App. 596, 599 (Ill. App. Ct. 1938); *Camerer v. California Sav. & Commercial Bank*, 4 Cal. 2d 159, 170 (Cal. 1935).

There is no case of which we are aware which articulates a principled basis for denying the creditors recovery through a trustee or receiver and allowing wrongdoers to escape liability.

In addition, there are practical benefits of allowing such recoveries, as Judge Posner also observed.

> The conceivable alternatives to these suits for getting the money back into the pockets of its rightful owners are a series of individual suits by the investors, which, even if successful, would multiply litigation; a class action by the investors – and class actions are clumsy devices; or, most plausibly, an adversary action, in bankruptcy, brought by the trustee in bankruptcy of the corporations if they were forced into bankruptcy.

Scholes v. Lehmann, 56 F.3d at 755.

For all of these reasons, denying application of the defense to a Trustee furthers the policies behind the *Bateman Eichler* rule.

B. The Trustee Here, Asserting a Claim Originally Held by an Innocent Victim of Fraud, was Not of Equal Fault with Defendants

In addition to the equities of allowing a trustee generally to be free of the burden of the *in pari delicto* defense, there is a further reason to deny the defense here because the wrongdoer, New Dictaphone, only acquired the claim for fraud on Old Dictaphone as a

result of the success of the wrongful merger. Because of the merger, the creditors of Old Dictaphone, became creditors of New Dictaphone. *See* Del. G.C.L. § 259.

In effect, the merger was a fraud on the creditors of Old Dictaphone and it destroyed the entire enterprise value of the entity the creditors were entitled to look to for recovery. Where the Trustee is seeking to obtain recompense from the participants in the fraud for the benefit of creditors who were the target of the fraud, barring that action is particularly inequitable.

C. Bankruptcy Code § 541 Neither Prohibits Consideration of Equities Presented by a Trustee Suit Nor Trumps this Court's *Bateman Eichler* Test in Determining the Proper Application of *In Pari Delicto*

The First Circuit below and the other circuits applying *in pari delicto* to defeat federal law based claims asserted by a bankruptcy trustee rely on their reading of Bankruptcy Code Section 541. As the Eleventh Circuit stated in *Edwards*, in language which best articulates the argument:

> Under the plain meaning of section 541(a), the debtor estate includes all "legal or equitable interests of the debtor as of the commencement of the case." 11 U.S.C. § 541(a) *(emphasis added)*. "A bankruptcy trustee stands in the shoes of the debtor and has standing to bring any suit that the debtor could have instituted" when the debtor filed for bankruptcy, and there is no suggestion in the text of the Bankruptcy Code that the trustee acquires rights and interests greater than those of the debtor. *O'Halloran*, 350 F.3d at 1202; see also 11 U.S.C. § 362(a). If a claim of ETS would have been subject to the defense of *in pari delicto* at the commence-

> ment of the bankruptcy, then the same claim, when asserted by the trustee, is subject to the same affirmative defense.

Official Comm. of Unsecured Creditors of PSA, Inc. v. Edwards, 437 F.3d at 1150.

However, the argument has been expressly rejected by numerous commentators[9] and at least one Bankruptcy court,[10] and is unsound for several reasons. First, Section 541 does not address the rights of trustees or the application of defenses at all, it merely identifies what is "property of the debtor." 11 U.S.C. § 541(a). Nothing in that section would seem to place any restriction on the discretion of a court of equity to apply equitable defenses in a manner which was equitable. Indeed, the discretion of the court in applying equitable defenses was a settled law at the time the section was enacted. *See, Keystone Driller Co. v. General Excavator Co.*, 290 U.S. 240, 245-246 (1933) ("courts of equity do not make the quality of suitors the test. They are not bound by formula or restrained by any limitation that tends to trammel the free and just exercise of discretion."); 1 Story, Commentaries on Equity Jurisprudence § 423, at 399-

[9] *See* Jeffrey Davis, *Ending the Nonsense: The In Pari Delicto Doctrine Has Nothing to Do with What is § 541 Property of the Bankruptcy Estate*, 21 Emory Bankr. Dv. J. 519 (Summer 2005); Tanvir Alalm, *Fraudulent Advisors Exploit Confusion in the Bankruptcy Code: How In Pari Delicto Has Been Perverted to Prevent Recovery for Innocent Creditors*, 77 Am Bannkr. L.J. 305 (Summer 2003); Gerald L. Baldwin, *In Pari Delicto Should Not Bar a Trustee's Recovery*, 23 Am. Bankr. Inst. J. 8 (Oct. 2004); *Making Sense of the In Pari Delicto Defense: "Who's Zoomin' Who?"* 23 No. 11 Bankr. Law Letter 1 (Nov. 2003); Robert T. Kugler, *The Role of Imputation and In Pari Delicto in Barring Claims Against Third Parties*, 1 No. 14 Andrews Bankr. Lit. Rep. 13 (2004).

[10] *Talz v. Proskauer Rose LLP (In re Fuzion Tech. Group, Inc.)*, 332 B.R. 225 (S.D. Fla 2005).

400 (14th ed. 1918); Pomeroy's Equity Jurisprudence, 4th Ed., Section 941, pp. 1998-9. There is no reason to believe that in enacting the section Congress intended to change that settled law.

Second, the defense of *in pari delicto* is one which is historically based on personal fault. The legislative history of the Section 541 expressly states that defenses that are "personal against the debtor" are *not* effective against the estate:

> Thus, as section 541(a)(1) clearly states, the estate is comprised of all legal or equitable interests of the debtor in property as of the commencement of the case. To the extent such an interest is limited in the hands of the debtor, it is equally limited in the hands of the estate *except to the extent that defenses are personal against the estate.*

11 U.S.C.A § 541 note (West 2004) Legislative Statements (emphasis added); 124 Cong. Rec. 32,399 (1978). *See, also,* 5 Collier on Bankruptcy ¶ 541.04 (15th rev. ed. 2004) ("To the extent an interest is limited in the hands of the debtor, it is equally limited as property of the estate *except to the extent that defenses which are personal against the debtor are not effective against the estate."* (emphasis added)); Jeffrey Davis, *Ending the Nonsense: The In Pari Delicto Doctrine Has Nothing to Do with What is § 541 Property of the Bankruptcy Estate,* 21 Emory Bankr. Dev. J. 519, 538-39 (Summer 2005) (same). *See also In re Fuzion Tech.,* 332 B.R. at 231-232 (same).

Third, finding that the Trustee is not barred by *in pari delicto* is consistent with by the rule of "absolute priority" embodied in the Bankruptcy Act and underlying much of

American jurisprudence.[11] Under "absolute priority" rule, where there is a business failure, creditors should recover prior to equity holders. The rule is abandoned by denying a Trustee the right to pursue such claims, but allowing shareholders to proceed unencumbered by the defense.

Fourth, and most importantly, there is nothing in Section 541 which would allow it to override the *Bateman Eichler* rule in cases brought by bankruptcy trustees. Were this Court to allow the broad interpretation of Section 541 to prevail, than *Bateman Eichler* would become largely irrelevant, applicable only in the exceptional cases where the defense is raised outside the bankruptcy context.

[11] The principles that creditors are paid in full before equity recovers any return, known as the "absolute priority" rule, has roots going back to *Northern Pacific R. Co. v. Boyd*, 228 U.S. 482 (1913) and has repeatedly been re-affirmed since. To allow equity holders to elevate their claims through the back door of direct actions would defeat the "absolute priority" rule, which underlies both bankruptcy practice and much of American business law. *Warren*, Bankruptcy Policy, 54 U. Chi. L. Rev. 775, 792 (1987) ("An almost axiomatic principle of business law is that, because equity owners stand to gain the most when a business succeeds, they should absorb the costs of the business's collapse—up to the full amount of their investment."). *See also Consol. Rock Prods. Co. v. Du bois*, 312 U.S. 510, 520-21 (1941) ("stockholders seeking to recover their investments cannot be paid before provable claims have been satisfied in full"); *Slain & Kripke, The Interface between Securities Regulation and Bankruptcy —Allocating the Risk of Illegal Securities Issuance Between Securities Holders and the Issuer's Creditors*, 48 N.Y.U.L. Rev. 261 (1973) (hereinafter "Slain/Kripke").

Accordingly, Section 510(b) of the Bankruptcy Code was enacted to subordinate any claim for damages "arising from the purchase or sale" of the securities of the debtor. That section was adopted as part of the 1978 enactment of the Bankruptcy Code to prevent "disappointed shareholders from recovering their investment loss by using fraud and other securities claims to bootstrap their way to parity with general unsecured creditors in a bankruptcy proceeding." *In re Telegroup, Inc. v. Telegroup, Inc.*, 281 F.3d 133, 142 (3d Cir. 2002).

2. Allowing *In Pari Delicto* to Defeat Claims of Defrauded Merger Targets Substantially Interferes with the Policies of the Federal Securities Law

The First Circuit's fixed focus on the Trustee as a wrongdoer by imputation also caused the court of appeals to misapply the second prong of the Bateman Eichler test. The First Circuit held:

> As we have pointed out, the trustee is not bringing claims on behalf of an innocent target of the fraud but, rather, on behalf of a complicit party. Viewed in that light, the trustee's policy concerns ring hollow. *See Edwards*, 437 F.3d at 1155 (finding public policy exception inapplicable in analogous circumstances) . . . To permit the trustee to proceed in these circumstances would be equivalent to giving New Dictaphone a second bite at the cherry, allowing it first to reap the benefits of the fraud and then to attack the defrauders.

App. at 23a, footnote omitted.

A similar approach was taken by the Eleventh Circuit in *Edwards* to bar a suit by a Trustee under RICO. *Official Comm. of Unsecured Creditors of PSA, Inc. v. Edwards*, 437 F.3d at 1155.

It is, of course true, that, as the First Circuit held, that "[t]he securities laws were enacted to protect investors from deceptive practices, see *Pinter*, 486 U.S. at 638, not to give the intended beneficiaries of deceptive practices a back-door means of ensuring a profit." App. at 23a. Yet, if the second prong of the *Bateman Eichler* were readily avoided by simply labeling the plaintiff a wrongdoer, there would be no case where the court could find that the plaintiff was "equally" culpable under *Bateman Eichler's* prong one, yet application of the defense

could nonetheless be barred under prong two on the ground that it "interfere[d] with the effective enforcement of the securities laws."

As this Court has noted, "labels, as often is the case, merely state the conclusion reached, but do not aid in solution of the problem. The ultimate issue is whether the result in the particular case would effectuate or frustrate the purposes of the [Securities] Act." 312 U.S., at 44, n. 2. *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. at 311, n. 20, *citing A. C. Frost & Co. v. Coeur D'Alene Mines Corp.*, 312 U.S. 38, 43 (1941)

Indeed, an argument that the First and Eleventh Circuits rely on was raised and rejected by this Court in *Pinter v. Dahl*, 486 U.S. 622, 637 (1988). As the Court there held, the "broad policies" of the securities laws are

> "protection of investors as a group, not as individuals, and the need for a healthy economy constantly purged by full disclosure. *See, e. g., SEC v. North American Research & Development Corp.*, 280 F. Supp. 106, 121 (SDNY 1968) (purpose of § 5 is to protect public investors through disclosure), *aff'd* in part and vacated in part on other grounds, 424 F.2d 63 (CA2 1970).

Id. at 637, n. 14.

Allowing a relatively culpable party to recover may therefore be allowed when that approach serves to protect "the unknowing and innocent investor." *See, id.* at 637. As this Court held in *Perma Life Mufflers v. International Parts Corp.*, 392 U.S. 134 (1968):

> The plaintiff who reaps the reward of treble damages may be no less morally reprehensible than the defendant, but the law encourages his suit to further the overriding public policy in favor of competition. A more fastidious regard for the relative moral

> worth of the parties would only result in seriously undermining the usefulness of the private action as a bulwark of anti-trust enforcement.

Id. at 139.

Such an approach would seem to be particularly appropriate in this case where the "guilt" of the Trustee is only by imputation, and the claim was acquired by the "guilty" entity only because of the success of the fraud.

Applying the more searching analysis required by *Bateman Eichler* and *Pinter* makes it clear that denying recovery in this case would dramatically interfere with the purposes of the securities laws under which the Trustee seeks to recover. Here, Old Dictaphone was the target of a fraud designed to cause the corporation to surrender its business and assets for consideration that was essentially worthless. Since the object of the fraud was the acquisition of Old Dictaphone by L&H through its subsidiary "New Dictaphone," by definition, the fraud only could succeed if, as occurred here, Old Dictaphone and its fraud claim were acquired by New Dictaphone. If the fact of that acquisition *by itself* is sufficient to bar even an innocent successor Trustee from pursuing claims against the participants in the fraud, than fraud by an acquirer against a merger target would always, *a fortiori*, be insulated from damage claims.

It is hard to see how protecting perpetrators of fraud from the consequences of their actions would not interfere the purposes of the securities laws, for "full disclosure." By contrast, allowing suits, such as the suit by the Trustee in this case, provides a strong incentive to disclosure, which advances the purposes of the securities laws. Such a rule serves to protect innocent investors in other cases and to deter, rather than encourage, fraud in connection with the merger transactions.

3. Allowing Bankruptcy Code Section 541 to Federalize the Application of State Law Claims of *In Pari Delicto* Violates this Court's Holding in *O'Melveny & Myers v. FDIC* and is also an Important Issue Meriting Review by this Court .

The effect of the approach adopted by the First Circuit in this case and by the *Lafferty* and *Edwards* courts does not merely interfere with the Federal policies on application of the *in pari delicto* defense, it also overrides state *in pari delicto* law in a manner which is in direct conflict with this Court's decision in *O'Melveny & Myers v. FDIC*, 512 U.S. 79 (1994).

In *O'Melveny*, the FDIC as a receiver for a failed bank brought suit against the bank's attorneys for negligence and breach of fiduciary duty arising out of the attorneys' failure to discover the bank's fraudulent conduct. The district court dismissed based on the imputation of the bank's knowledge to the receiver, but the 9th Circuit reversed holding that finding "federal pre-emption not over the law of imputation generally, but only over its application to the FDIC suing as receiver." *Id.* at 85. The 9th Circuit held the receiver was not barred from proceeding with claims that the bank could not itself assert.

This Court reversed finding that the creation of federal law of imputation was inappropriate, and the rules regarding whether receivers could or could not sue where their predecessor corporation was barred from suit must be decided as a matter of state law. *Id.* at 87-88.

Justice Stevens concurred, joined by Justices Blackmun, O'Conner and Souter, to emphasize that "[i]t would be entirely proper for a state court of general jurisdiction to fashion a rule of agency law that would protect creditors of an insolvent corporation from the consequences of wrongdoing by corporate officers even

if the corporation itself, or its shareholders, would be bound by the acts of its agents. *Id.* at 90.

Justice Stevens' concurrence also noted that where the state law is unclear "federal judges must do their best to estimate how the relevant state courts would perform their lawmaking task." *Id.*

On remand, the 9th Circuit adhered to its prior ruling as a matter of state law. *FDIC v. O'Melveny & Myers*, 61 F.3d 17, 19 (9th Cir. 1995).

While the First Circuit below did rely on state law of imputation to determine whether "New Dictaphone" would be held to be "of equal fault," on the determinative issue of whether *the Trustee* was barred by *in pari delicto* if the defense was applicable to New Dictaphone, the court of appeals ignored state law entirely. Instead, citing only Federal law, Bankruptcy Code Section 541, and Federal Cases, the court of appeals held that "the trustee may assert only those claims that New Dictaphone could have asserted prior to seeking the protection of the bankruptcy court." App. at 14a.

The reasoning, however, is flawed. There is no more basis for a federal rule of Trustee standing in this case than there was in *O'Melveny*. Bankruptcy Code Section 541 does not address the standing of a Bankruptcy Trustee (let alone a Litigation Trustee like plaintiff). Instead it merely identifies property of the Estate.[12]

While the First Circuit and the cases on which it relies interpret the language of Section 541 broadly to create

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[12] § 541. Property of the estate

(a) The commencement of a case under section 301, 302, or 303 of this title [11 USCS § 301, 302, or 303] creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held: (1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

federal law regarding defenses available against a bankruptcy trustee, this court was faced with similar language in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. 101-73, 103 Stat. 183, which established the right of the FDIC as receiver in *O'Melveny*.[13] Yet, in *O'Melveny*, FIRREA did not compel a federal rule of law denying the FDIC receiver the right to pursue claims barred as to its predecessor. For the same reasons, Section 541 does not establish a federal rule denying bankruptcy trustees the right to pursue claims which might be denied to the debtor itself.

While this Court will leave the resolution of the state law issue to the court of appeals on remand, there is good reason to believe that under general equitable principles, the Massachusetts courts would allow the Trustee in this case to pursue the wrongdoers free of the *in pari delicto* defense. *See, Choquette v. Isacoff*, 836 N.E.2d 329, 332-333 (Mass. App. Ct. 2005). Here, at the time the claim arose, it was the claim of the innocent victim, Dictaphone. It only briefly passed through the hands of "New Dictaphone. Massachusetts law does recognize limitations on the defense based on the equities of the case. It could well be determined that Massachusetts law would bar the defense of *in pari delicto* against the Trustee under these facts.

Similarly, the other cases to have likewise applied Section 541 to federalize the issue of defenses available against the Trustee have done so without attempting to analyze conflicting state law on the issue. *Compare,*

[13] Section 1821(d)(2)(A)(i), which is part of a title captioned "Powers and duties of [the FDIC] as . . . receiver," states that HN4"the [FDIC] shall, . . . by operation of law, succeed to—all rights, titles, powers, and privileges of the insured depository institution . . . ." 12 U.S.C. § 1821(d)(2)(A)(i) (1988 ed., Supp. IV). *O'Melveny & Myers v. FDIC*, 512 U.S. at 86.

Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., 267 F.3d 340, 356 (3d Cir. 2001) (applying *in pari delicto* to Pennsylvania law claim by Creditors Committee), with *Universal Builders, Inc. v. Moon Motor Lodge, Inc.*, 430 Pa. 550 (Pa. 1968) (holding under Pennsylvania law that *in pari delicto* defense should not be applied to deny a plaintiff bankruptcy trustee recovery); *Adelphia Communs. Corp. v. Bank of Am. (In re Adelphia Communs. Corp.)*, 330 B.R. 364, 381 (Bankr. D.N.Y. 2005) (same); *Waslow v Grant Thornton LLP (In re Jack Greenberg, Inc.)*, 240 B.R. 486 (Bankr. E.D. Pa. 1999) (Sigmund, J.) ("Jack Greenberg") (rejecting *in pari delicto* defense in action brought against accountants by chapter 7 trustee) and *Official Comm. of Unsecured Creditors of PSA, Inc. v. Edwards*, 437 F.3d 1145, 1151 (11th Cir. 2006) ("the defense of *in pari delicto* may be asserted against a bankruptcy trustee") with *Brooke v. Kennedy*, 172 Ga. 461, 463-464 (Ga. 1931) (rejecting the defense against a receiver "These contracts were assets which came into the hands of the receiver, and from which creditors should be paid. It would require a strong case for a court of equity under such circumstances to refuse the creditors protection through a receiver . . .").

Equally pernicious, the federalization of defenses to state law causes of action by a Trustee has distorted the application of the defense of *in pari delicto* in state courts as well. *See, Peregrine Funding, Inc. v. Sheppard Mullin Richter & Hampton LLP*, 133 Cal. App. 4th 658, 680 (Cal. Ct. App. 2005) (applying *in pari delicto* defense to claims of bankruptcy trustee on the basis of federal cases construing Section 541.)

Section 541 should not be used to federalize state law of imputation in cases where state law governs the defense. For this reason as well, this case merits review by this Court.

CONCLUSION

For all of the above reasons, each of which is independently sufficient, petitioner respectfully requests that this Court issue a writ of certiorari.

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Respectfully Submitted,

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